Ministry for Primary Industries
Manatū Ahu Matua

SITUATION AND OUTLOOK FOR PRIMARY INDUSTRIES
UPDATE JANUARY 2014

Growing and Protecting New Zealand

HIGHLIGHTS

The current year (July 2013 to June 2014) has a revised forecast increase of $4.9 billion, bringing the total export forecast to $36.5 billion (in nominal terms). This is based on November 2013 data.

TABLE 1: SITUATION AND OUTLOOK FOR PRIMARY INDUSTRIES UPDATED FORECAST TOTALS ($ MILLION)

FORECAST TOTALS	2011/12	2012/13	2013/14	2014/15
SOPI 2013	$32 021	$30 713	$31 552	$33 070
SOPI 2014 Update	$32 021	$32 187	$36 463	$35 713
Total Forecast Change	**$ 0**	**$1 474**	**$4 911**	**$2 643**

Sources: Statistics New Zealand and MPI.

TABLE 2: $4.9 BILLION INCREASE FOR 2013/14 BY SECTOR ($ MILLION)*

ADDITIONAL FORECAST VALUE	SOPI 2013	SOPI UPDATE	DIFFERENCE	% INCREASE ON SOPI 2013
Dairy	$13 962	$16 690	$2 728	19.5%
Meat	$5 434	$6 636	$1 202	22.1%
Forestry	$4 291	$5 111	$820	19.1%
Seafood	$1 528	$1 580	$52	3.4%
Horticulture	$3 187	$3 296	$109	3.4%
Other	$3 150	$3 150	$–	0.0%
Total Update	**$31 552**	**$36 463**	**$4 911**	**15.6%**

* Forecast update is provided for the main primary industry sectors only.

Growing demand for dairy products in emerging markets and limited milk supply from other major dairy exporters (particularly the United States and European Union) is enabling both value and volume gains for New Zealand dairy exporters. The net effect is a $2.7 billion increase in forecast dairy revenues over the *SOPI 2013* forecast.

Over the current year, lower beef production in the US and EU, as well as higher than expected prices for both beef and lamb means meat sector export revenues are expected to rise by $1.2 billion above the *SOPI 2013* forecast.

Forestry also has a significant uplift in the current year due to increased log export prices. This will drive a greater export volume as forestry firms are able to take advantage of higher international prices by increasing harvest rates.

There are two key drivers of the updated forecast increases:

» New Zealand exporters are able to direct product into emerging markets to meet the rapidly growing demand. This is predominantly increased volume of exports to China.

» Supply constraints among our major export competitors causing rising prices on international markets. This is largely due to US and EU diminished dairy and beef production.

This situation is not typical, and New Zealand exporters have demonstrated they are well positioned and agile enough to take advantage of such rapid changes in market conditions. The following table illustrates the extent to which forecasts for the coming year have been revised upwards (particularly in the dairy and forestry sectors).

TABLE 3: LATEST FORECAST FIGURES FOR 2013/14 TO 2014/15 ($ MILLION)

					YEAR-ON-YEAR CHANGES	
SOPI UPDATE	**2011/12**	**2012/13**	**2013/14**	**2014/15**	**2013/14**	**2014/15**
Dairy	$13 659	$13 442	$16 690	$14 916	24.2%	–10.6%
Meat	$6 613	$6 620	$6 636	$7 034	0.2%	6.0%
Forestry	$4 272	$4 478	$5 111	$5 284	14.1%	3.4%
Seafood	$1 500	$1 466	$1 580	$1 650	7.8%	4.4%
Horticulture	$3 127	$3 181	$3 296	$3 521	3.6%	6.8%
Other	$2 850	$3 000	$3 150	$3 308	5.0%	5.0%
Total Update	**$32 021**	**$32 187**	**$36 463**	**$35 713**	**13.3%**	**–2.1%**

Sources: Statistics New Zealand and MPI.

This highlights the importance of access to a diverse range of markets – both from the perspective of increasing revenue and managing risk. The potential impact of trade negotiations such as the TPP agreement will provide a substantial reduction in trade barriers, especially for dairy, meat, forestry, and horticulture. Producers here have demonstrated they are well prepared to take advantage of a changing trade environment, and New Zealand's agriculture sector holds a significant comparative advantage, particularly in the Pacific Rim. The challenge for New Zealand agri-business is to manage the balance between production, resource, and environmental impacts.

GLOBAL ECONOMIC TRENDS

Global economic expansion has been constrained during 2013 despite easing financial conditions. The majority of economic momentum has built up over the last six months with many regions experiencing moderate economic growth.

INTERNATIONAL TRADE FLOWS

After a slowdown in 2012, international trade is projected to pick up moderately during 2013/14. This is in line with the mild expected recovery in global aggregate demand. While agricultural trade has historically been characterised by policy-induced production surpluses, policy reforms over the last decade have changed supply and demand fundamentals, leading to agricultural trade becoming more market-driven. Future growth in agricultural trade is projected to increase rapidly with developing countries capturing the lion's share. (See sidebar on China).

COMMODITY PRICES

Despite being high by historical standards, commodity prices have faced some downward pressure. Aggregate commodity prices have declined marginally due to diminished global demand. A further declining trend is expected as supply of metals and oil is likely to expand notably, and the US dollar is expected to strengthen against other major currencies.

The prices of agricultural commodities have eased somewhat as supply improved during 2013. The relatively high prices for key commodities in recent years have encouraged farmers to increase planting areas.

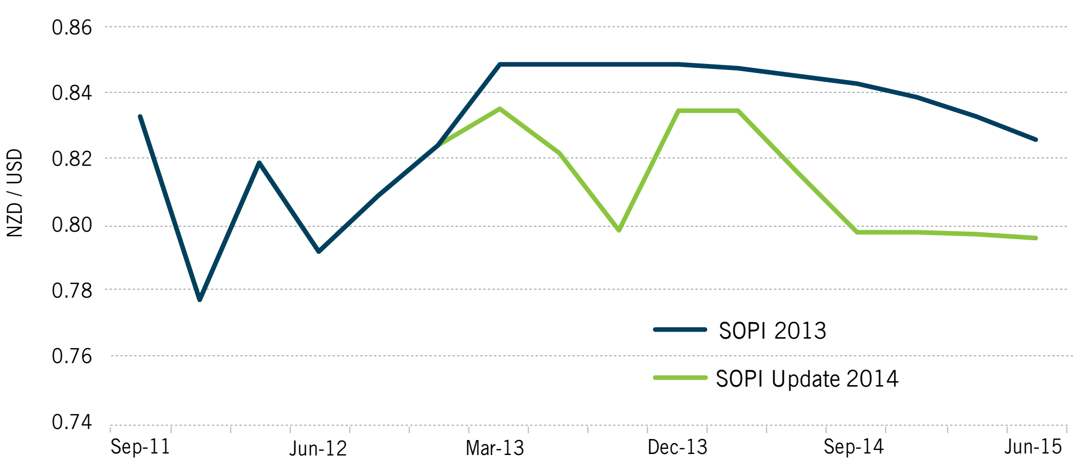
EXCHANGE RATES

Coming into January, the Euro (EUR) and Chinese Yuan (CNY) are the year-to-date high performers, up 3 percent and 2 percent respectively against the USD. Most other currencies have lost ground against the USD, with the worst performers being the Indonesian rupiah (IDR) and Japanese Yen (JPY), down 19 percent and 15 percent respectively. In 2014 broad based USD strength is expected, with the EUR and JPY underperforming, the AUD, CAD, and GBP undergoing modest weakening, and the NZD and NOK outperforming both the USD and other currencies.

The core drivers of foreign exchange rates remain: relative central bank policy, global growth outlook, and international politics.

The NZD/USD exchange rate has been lowered slightly from *SOPI 2013* as a result of updated assumptions from Treasury.

FIGURE 1: NZD/USD FORECAST UPDATE



WHAT'S IN STORE FOR CHINA IN 2013?

Extracts from a report by McKinsey & Co. (January 2013)

China has shifted rapidly from a trade balance on agricultural goods to a deficit that is currently around $40 billion (US) and growing at 50 percent a year. This transformation reflects increased demand in China for basic cereals to feed its expanding livestock. China is now the second largest importer of rice and barley, and a top ten importer of corn. Chinese companies lease hundreds of thousands of hectares from Argentina to Kazakhstan to grow soybeans.

Outbound investors can also see a growing opportunity for premium fruits and vegetables. And this is not only state-owned enterprises spending their spare cash. Many private Chinese entrepreneurs, who have been wildly successful in areas from real estate to technology, have identified the food chain as their next big investment opportunity.

The Shanghai Zhongfu Group has diversified from real estate in Shanghai by investing around $728 million in a sugar cane project in Western Australia. And at a major conference in Beijing a year ago, Chinese private equity firms met with senior executives of US food companies and representatives of US state agriculture bureaus to discuss ways of increasing China's investment in US agriculture.

The full report is available at http://www.mckinsey.com/insights/asia-pacific/forecasting_china

DAIRY FORECAST AND DRIVERS

The short-term forecast for farm-gate milk prices has been revised to accommodate the impact of strong international dairy prices over the past two quarters.

The net result is an increase of 19.5 percent over the dairy forecast figures in *SOPI 2013*. This equates to an additional $2.7 billion coming into the forecast, bringing the total 2013/14 dairy forecast to $16.69 billion.

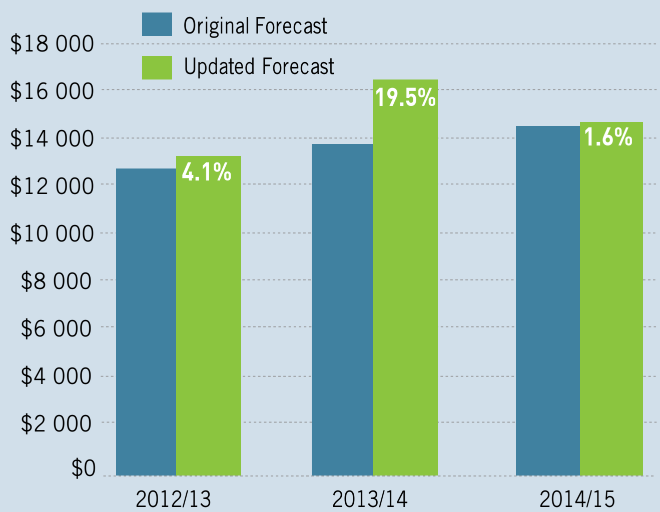
Change factors

Key factors influencing the change in forecast values include:

- Recent years' constrained supply is gradually easing as the sector receives investment for increasing production.
- International dairy prices increasing as a result of historic supply constraints.

DAIRY FORECAST COMPARISON ($ MILLIONS)

	2012/13	2013/14	2014/15
Original Forecast	$12,913	$13,962	$14,682
Updated Forecast	$13,442	$16,690	$14,916
Percentage change	**4.1%**	**19.5%**	**1.6%**



Production drivers

Assuming a return to average climatic conditions, milk production is expected to increase by 6.7 percent. This increase makes up for the production decline in 2012/13, and is due to an increase in the total size of the dairy herd and an increase in milk production per cow.

Internationally, milk production is picking up, driven by high dairy prices and lower feed costs. Notably milk production in the US and EU has been increasing steadily since April 2013 and July 2013 respectively.

Demand drivers

International dairy prices will continue to sit at relatively high levels as a result of the growing demand for dairy exports in emerging markets. This ongoing demand growth will offset the price impact of increasing supply coming from the US and EU.

To meet demand, many Asian countries have significantly increased milk and dairy imports. The region now accounts for 57 percent of the global trade in milk powders, and 20 percent of cheese imports.

MEAT AND WOOL FORECAST AND DRIVERS

Export revenue from meat, pelt, and wool products is forecast to reach $6.64 billion for 2013/14. This is an increase of 22.1 percent over the forecast provided in *SOPI 2013*, and is primarily due to increasing international prices and volumes, particularly to China.

Change factors

Key factors influencing the change in forecast values include:

» Decreasing beef supply in the US as a result of destocking caused by drought.

» Increasing demand for beef imports in the US, and consequently beef prices remain high.

» Increasing production in New Zealand for both beef and lamb.

» Decreasing global supply increasing demand for wool products (particularly China).

Production drivers

The domestic sheep flock is decreasing in head count, however improvements in lambing rates and carcass weights partially offset the reduction in animal numbers.

Similarly to the sheep flock, the beef cattle herd is undergoing a decrease in overall headcount. Again, this decrease is offset by productivity gains.

Demand drivers

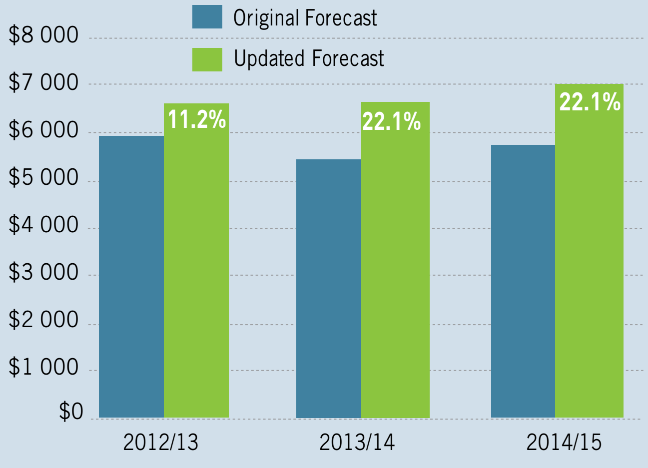
China will continue to be a big market for beef and lamb, though exporters may try to manage exposure in this market due to ongoing trade challenges.

Continued shortfall in beef production will keep prices up, and the increases in Indonesian quota volumes will contribute to a good performance for the sector in 2014.

Recovery in traditional markets is set to continue with increasing demand for chilled lamb coming from the UK in the lead up to the Northern Hemisphere spring season.

MEAT AND WOOL FORECAST COMPARISON ($ MILLIONS)

	2012/13	2013/14	2014/15
Original Forecast	$5 953	$5 434	$5 759
Updated Forecast	$6 620	$6 636	$7 034
Percentage change	**11.2%**	**22.1%**	**22.1%**



FORESTRY FORECAST AND DRIVERS

The total value of forest product exports for 2013/14 is forecast to increase 19.1 percent to $5.1 billion. This is primarily due to average log export prices increasing by 30 percent to $150 per cubic metre in the second half of 2013. Foresters have responded to these higher prices by increasing harvest rates and log exports.

China is the leading market for New Zealand log exports. Port inventories there are currently low (around one month's supply) which will keep prices high through early 2014. Limited supply from other major log exporters has allowed New Zealand to increase its share of the Chinese market.

Change factors

Key factors influencing the change in forecast values include:

- Steadily increasing international log prices leading to higher returns and export volumes.
- Sawn timber prices are similarly increasing, though there is not expected to be an increase in export volume over the coming year.

Production drivers

The key constraint on log production is the sustainable cap on harvest volume. Log production is limited by the sector's supply capacity, and this capacity is unlikely to change significantly in the next two years.

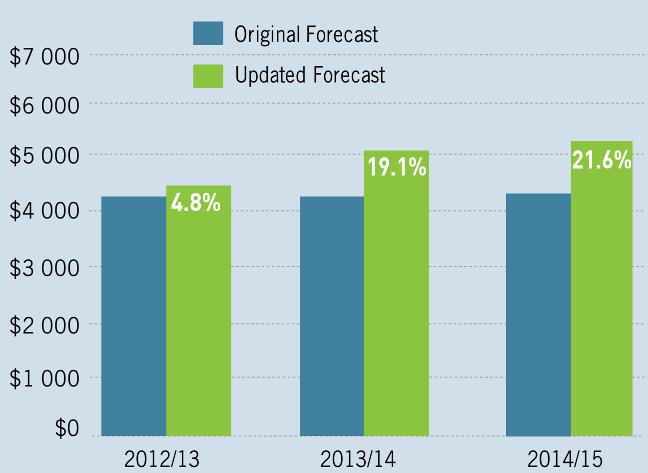
Furthermore, the closure of a large Rotorua sawmill will mean the available volume of sawn timber for export will decrease over the coming year.

Demand drivers

China remains the key market for New Zealand log exports. In 2013, New Zealand became the major softwood log exporter to China – surpassing Russia. Port inventories in China are low due to limited volume from alternate suppliers and this is likely to keep export values high through the start of 2014.

FORESTRY FORECAST COMPARISON ($ MILLIONS)

	2012/13	2013/14	2014/15
Original Forecast	$4 272	$4 291	$4 347
Updated Forecast	$4 478	$5 111	$5 284
Percentage change	**4.8%**	**19.1%**	**21.6%**



SEAFOOD FORECAST AND DRIVERS

Forecast export earnings for both wild capture fisheries and aquaculture are up for 2013/14. Overall, export volumes are predicted to decline by 8000 tonnes from the *SOPI 2013* forecast, however this is offset by an average price increase from $5.10 per kg to $5.40 per kilogram.

During 2013 our largest export market, China, has continued to grow in terms of volume and value.

Change factors

Key factors influencing the change in forecast values include:

» Wild capture fisheries are expecting a decrease in export volume, but this is offset by a net value increase of $10 million.

» Aquaculture sees similar dynamics with a decrease in export volume offset by a net value increase of $41.5 million.

Production drivers

The forecast for wild capture fisheries sees a decline in export volumes for a number of species, for example, southern blue whiting and squid. These volumes have shifted down from *SOPI 2013*. Slightly offsetting these volume decreases, the recent increase in Total Allowable Commercial Catch for hoki will see some of the export revenue claimed back.

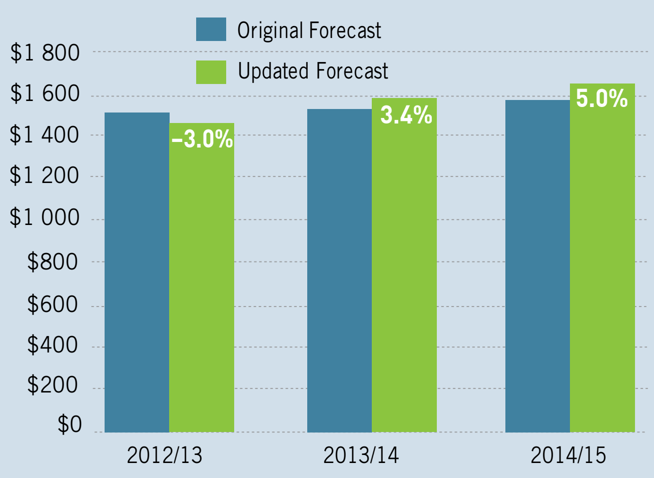
Aquaculture production has been mainly affected by the decreased mussel production in 2013 and the flow-on effects to the current year. Over the coming years, production will return to historic levels.

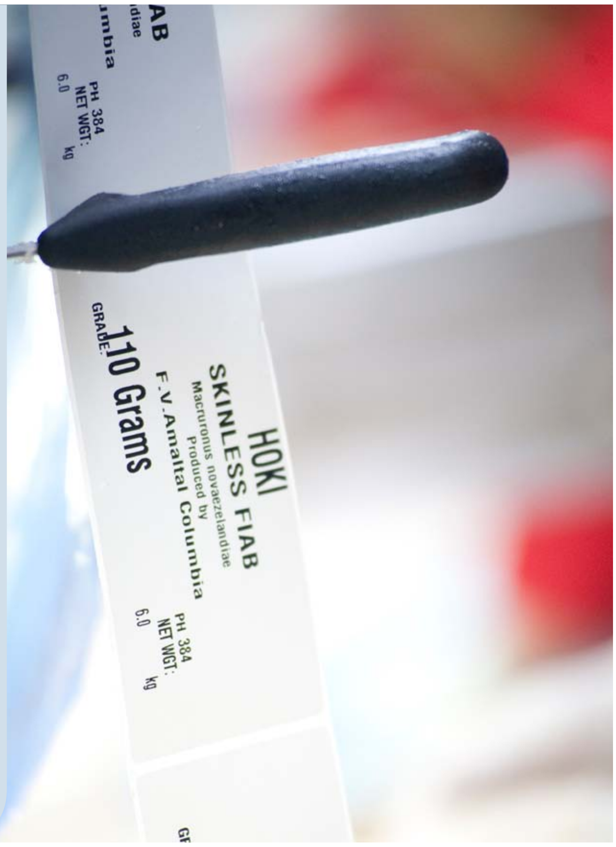
Demand drivers

Export prices across the sector are holding up well as demand from China continues to grow. Demand in other markets has diminished, notably in Japan, South Korea, and the EU. This trend is expected to continue through the year.

SEAFOOD FORECAST COMPARISON ($ MILLIONS)

	2012/13	2013/14	2014/15
Original Forecast	$1 512	$1 528	$1 572
Updated Forecast	$1 466	$1 580	$1 650
Percentage change	**–3.0%**	**3.4%**	**5.0%**





HORTICULTURE FORECAST AND DRIVERS

The horticulture sector shows a mix of supply and demand dynamics affecting sectors in a range of ways. Overall, the forecasts for the sector are close to the original *SOPI 2013* forecast, however, specific sectoral changes are detailed below.

Change factors

Key factors influencing the change in forecast values include:

- Volume increases for wine growers reflect a good season, and prices are expected to stay strong in North America, China, and the EU.
- A good season for apples has lead to a higher than expected export volume, though prices are expected to drop somewhat due to increasing competiveness among southern hemisphere exporters.

Production drivers

The major production shift in the horticulture sector relates to gold kiwifruit. Export volumes for this product category are expected to halve in the current season due to Psa. As of November 2013, 77 percent of kiwifruit orchards are known to have Psa, up from 68 percent a year ago. However, gold volumes are expected to recover over the coming years, with 4000 hectares licensed to grow the Gold3 cultivar.

Current year apple production has been robust as a result of a good season and favourable climatic conditions. Export volumes are expected to increase further over the next three years as additional plantings become productive.

There is no major change to production forecasts for the wine and vegetable segments.

Demand drivers

With the lower gold kiwifruit volumes in the market, consumer demand for green kiwifruit has lifted. This demand, coupled with strong supply chain performance and low fruit loss will produce a significant lift in orchard gate returns this year.

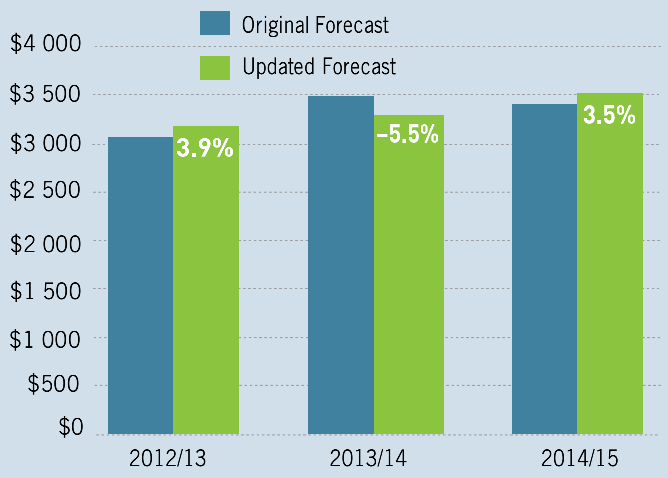
Increased local supplies of apples in Europe and the US will mean a more competitive market for Southern Hemisphere pipfruit in 2014, and hence a drop in export prices is anticipated.

For the wine sector, demand for premium New Zealand product is expected to continue growing, especially in key markets.

In the vegetable segment, demand forecasts have not changed significantly from *SOPI 2013.*

HORTICULTURE FORECAST COMPARISON ($ MILLIONS)

	2012/13	2013/14	2014/15
Original Forecast	$3 063	$3 487	$3 402
Updated Forecast	$3 181	$3 296	$3 521
Percentage change	**3.9%**	**–5.5%**	**3.5%**



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